**STATE OF ILLINOIS**
**ILLINOIS COMMERCE COMMISSION**

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| **COMMONWEALTH EDISON COMPANY** | **)** | |
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| **Annual formula rate update and revenue requirement reconciliation under Section 16-108.5 of the Public Utilities Act.** | **)** | **Docket No. 14-0312** |

# REPLY BRIEF OF

# THE PEOPLE OF THE STATE OF ILLINOIS


**The People of the State of Illinois**

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The People of the State of Illinois, by and through Lisa Madigan, Attorney General of the State of Illinois, hereby file their Reply Brief in the above-captioned proceeding.

## I. INTRODUCTION / STATEMENT OF THE CASE

The People will respond in this Reply Brief to the Initial Briefs of Commonwealth Edison Company ("ComEd" or the "Company") and the Staff of the Illinois Commerce Commission ("Staff"), filed September 10, 2014. The People's failure to respond to other parties' Initial Briefs should not be viewed as agreement or disagreement with the proposals advanced in those other Initial Briefs.

As discussed in their Initial Brief[1], the People continue to recommend adjustments on the following issues, and will discuss these issues in depth below:

- Incentive compensation, including the Annual Incentive Program ("AIP") and Long Term Performance Share Award Program ("LTPSAP");
- Interest on the annual reconciliation balance, or, in the alternative, deferred income tax associated with the reconciliation balance;
- Billing determinants.

[1] The People's references in this Reply Brief to their own "Initial Brief" should be taken to refer to their Second Corrected Initial Brief, filed September 16, 2014.

The People will not present argument or comment on other adjustments recommended by other parties. However, this should not be taken as an opposition to or agreement with those adjustments.

## II. OVERALL REVENUE REQUIREMENT

### A. 2015 INITIAL RATE YEAR REVENUE REQUIREMENT

### B. 2013 RECONCILIATION ADJUSTMENT

### C. ROE COLLAR

### D. 2015 RATE YEAR NET REVENUE REQUIREMENT

## III. SCOPE OF PROCEEDING

### A. CHANGES TO THE STRUCTURE OR PROTOCOLS OF THE PERFORMANCE-BASED FORMULA RATE

### B. THE DEFINITION OF RATE YEAR AND THE RECONCILIATION CYCLE

### C. ORIGINAL COST FINDING

### D. ISSUES PENDING ON APPEAL

## IV. RATE BASE

### C. POTENTIALLY CONTESTED ISSUES

#### 2. Other

The People continue to recommend adjustments to rate base associated with their adjustments to the AIP and LTPSAP incentive compensation plans. The rate base adjustment is associated with the incentive compensation expense adjustments and will be discussed in section V.C.2. below.

The People also recommend, as an alternative adjustment to applying interest to the net-of-tax reconciliation under-collection discussed in section VII.B below, that the ADIT associated with the delayed recovery and taxation of reconciliation revenues be deducted from rate base, in the same manner as other ADIT balances recognized within rate base applicable to the delivery services jurisdiction. This adjustment is discussed in section VII.B below.

## V. OPERATING EXPENSES

### C. Potentially Contested Issues

#### 1. Depreciation for the Filing Year Revenue Requirement

#### 2. Incentive Compensation Program Expenses

##### a. Annual Incentive Program ("AIP")

ComEd's Initial Brief contains a number of misrepresentations of the evidentiary record in this case and applicable legal precedent in an effort to build an argument that the 2013 Annual Incentive Program ("AIP") expense was not "based on" the earnings per share ("EPS") of Exelon Corp., ComEd's parent company. The parts of this Reply Brief to follow will demonstrate why the Shareholder Protection Feature in the 2013 AIP *does*, in fact, cause 2013 AIP expense to be "based on" Exelon EPS for purposes of Section 16-108.5(c)(4)(A) of the Energy Infrastructure Modernization Act ("EIMA").

The People do not dispute, as ComEd states at page 38 of its Initial Brief, that "ComEd's AIP incorporates the specific operational and cost control metrics set forth in EIMA and incentivizes every employee to meet those metrics, all of which benefits customers." However, it is not true that "ComEd's incentive compensation expense does in fact reflect *only* the achievement of those recoverable operational and cost control metrics" (emphasis added), as

ComEd suggested at page 40 of its Initial Brief, or that "not a dollar of ComEd's AIP *expense*[2] resulted from anything other than ComEd's achievement of those KPIs" (emphasis in the original), as ComEd stated at page 41 of its Initial Brief. In fact, as the People showed from pages 12-18 of their Initial Brief, all of ComEd's AIP expense necessarily, under the AIP's own terms, makes reference to Exelon Corp. earnings per share through the Shareholder Protection Feature to determine what range of AIP pay will be allowed: a percentage performance of Exelon Corp. EPS is determined, and then that percentage plus 20 more percentage points is the maximum allowable Company Performance Multiplier (but the effective Company Performance Multiplier will be reduced all the way to zero if the "threshold" level of Exelon EPS is not met).

Thus, if the effective Company Performance Multiplier allowed by the Shareholder Protection Feature is equal to the Company Performance Multiplier actually earned through operational Key Performance Indicators ("KPIs"),that "reflects" Exelon EPS being sufficiently high so as not to limit the Company Performance Multiplier. If the effective Company Performance Multiplier allowed by the Shareholder Protection Feature is *less* than the Company Performance Multiplier actually earned through operational KPIs, that reflects Exelon EPS being low enough to limit the Company Performance Multiplier. Staff witness Bridal presented a table in his rebuttal testimony, reproduced at page 15, footnote 12 of the People's Initial Brief, illustrating the sensitivity of AIP pay to various hypothetical realizations of Exelon Corp. EPS. Staff Ex. 8.0 at 20:451. The People also illustrated the sensitivity of actual AIP pay to Exelon EPS with two hypothetical examples at page 16 of their Initial Brief. Had Exelon non-GAAP

[2] ComEd claims at page 41 of its Initial Brief that "[t]he amount of AIP compensation paid out is undeniably limited or affected or impacted . . . by Exelon's EPS, but the amount earned is not. . . . ComEd's incentive compensation expense cannot therefore be based on Exelon's EPS." However, ComEd already admitted that the expense amount at issue in this proceeding is the AIP pay amount actually paid out and not the amount "earned" or "funded", as the People showed at page 15, footnote 13 of their Initial Brief; thus, ComEd's syllogism fails on its own terms.

EPS for 2013 been four cents higher, the effective Company Performance Multiplier used in calculating AIP pay would have been 140.39%; had it been 29 cents lower, the effective Company Performance Multiplier would have been zero. While Exelon EPS is calculated only once and takes only one actual value for a given AIP year, its value has many *possible* realizations, and a higher actual realization as opposed to a lower actual realization can cause ComEd's AIP payout to be higher than it otherwise would be. *See also* the People's Initial Brief at page 16, footnote 14 for a discussion of the probabilistic aspect of Exelon EPS.

ComEd suggests at page 42 of its Initial Brief that the AIP "does not have the effect of incentivizing ComEd employees to increase EPS" and that "no evidence suggests that the limiter provides any benefit to shareholders" (*id.* at 45) but as the People showed at pages 20 and 22 of their Initial Brief, this is simply false; it is in the personal interest of ComEd employees to maximize the probability that Exelon's EPS will be high enough so as not to limit actual AIP payout, to the extent that such effort does not conflict with other goals. Given the structure of the formula rate process under EIMA, there are also several potential ways for ComEd employees to incrementally increase earnings, as the People described at pages 22-23 of their Initial Brief, including defeating expense disallowance proposals in the annual formula rate update cases so as to avoid a revenue reduction in the subsequent year; expanding sales; and discouraging energy efficiency efforts that would reduce usage. Because *actual revenues* are never reconciled under EIMA except through the Section 16-108.5(c)(5) return on equity ("ROE") "collar" calculation, which may *not* cause a dollar-for-dollar ratepayer credit[3] for every

[3] Footnote 18 on page 23 of the People's Initial Brief showed the greatest impact that a revenue disallowance could have, around $30 million, under the ROE "collar" regime of Section 16-108.5(c)(5); by the same logic, that is the greatest potential impact that incremental steps to increase revenue could have, though the impact could be less if ROE were already above the bottom of the "collar" before the incremental revenue-increasing steps were undertaken.

incremental revenue-increasing action, ComEd employees have a strong incentive to maximize actual revenues in order to improve ComEd earnings and thus Exelon EPS. The redirection of incentives[4] *away* from operational goals and *toward* Exelon EPS, as the People illustrated at pages 18-24 of their Initial Brief, calls into question the prudence of ComEd's 2013 AIP expense, contrary to ComEd's suggestion at page 41 of its Initial Brief that "no party disputes that ComEd's AIP expense was prudently and reasonably incurred."

While one can imagine a myriad of potential ways that ComEd employees[5] could increase earnings per share under the EIMA regime, ComEd relies on conclusory statements made by its witness Mr. Brookins during re-direct examination at the evidentiary hearing to the effect that the only "way to increase [earnings per share] would be to increase capital spending" (ComEd Initial Brief at 44). But Mr. Brookins's narrative assumed that incremental capital expenditure by ComEd would be funded half with equity (Tr. at 345:21-346:1) and thus, half the incremental after-tax return on rate base would be incremental net income. Tr. at 345:5-346:3. This leads to an obvious question, however: where is that equity is coming from? Mr.

[4] ComEd relies at page 41 of its Initial Brief on a curious statement made during re-direct examination at the evidentiary hearing by ComEd witness Mr. Prescott. ComEd counsel asked: "Can you think of any other examples where the amount of money earned is different than the amount taken home by employees?" Mr. Prescott replied: "I think a great way to illustrate this is to think about [that] what employees actually take home is based on, related to, influenced, however you want to think of it – on the income tax rules; but one would not argue that the Internal Revenue Code determines awards." Tr. at 293:18-294:4. But this comparison is inapposite, because "expense" for the purposes of this Commission proceeding is measured from the perspective of ComEd, not from its employees'. Individual income tax does not "limit" ComEd's actual expense in the way that the Shareholder Protection Feature does; the Shareholder Protection Feature acts to reduce the amount of ComEd's AIP expense, while income tax rules just divert a portion of ComEd's payroll expense to government while leaving unchanged the amount of expense. Individual income tax liability is a matter between each employee and the IRS; as Mr. Prescott admitted on re-cross examination, individual income tax rules "vary by individual." Tr. at 295:6. To the extent that Mr. Prescott was seeking to show that employee incentives are not diluted when their pay is reduced, he certainly did *not* show that employee motivation to meet operational KPIs would not be *greater* if income tax were hypothetically reduced or abolished.

[5] As discussed in the People's Initial Brief at page 12, footnote 8, the People's proposed disallowance of AIP pay includes pay made to Exelon Business Services Company employees, whose 2013 AIP pay was also subject to the Shareholder Protection Feature. As employees of an entity that services many Exelon affiliates, these employees likely have even greater scope than do ComEd employees to influence Exelon Corp. EPS.

Brookins's argument requires that the equity for the incremental capital expenditure come only from retained earnings. If the parent company issued any new shares to fund the equity portion of ComEd's incremental capital expenditure, either immediately or later as part of an Exelon-wide capital structure balancing, the denominator of the Exelon earnings per share calculation would increase as the numerator was increasing, so that Mr. Brookins's claimed channel for increasing Exelon EPS might not actually increase it. As the People observed at page 22 of their Initial Brief, Mr. Brookins never established through statements or evidence that Exelon Corp. does *not* raise new equity when it funds ComEd's capital expenditure, calling into question the veracity of his assertion.

ComEd suggests at page 45 of its Initial Brief that the Shareholder Protection Feature "benefited customers" by reducing incentive compensation expense. While it may be true that ratepayers pay lower rates when recoverable expenses are lower (all else being equal), it is not clear, as the People discussed in their Initial Brief at 4, that a percentage performance of Exelon EPS that is sufficiently below the ComEd KPI percentage performance creates a real need to protect customers from high rates. As AG witness Brosch stated in his rebuttal testimony, "[i]f AIP awards payable for achievement of operational performance are excessive, this would be true without regard to Exelon's achieved EPS." AG Ex. 3.0C at 27:609-611.

ComEd writes at page 43 of its Initial Brief that "the operational and cost control metrics explicitly deemed permissible in EIMA, such as the EIMA reliability index metric, are related to and can *decrease* Exelon's EPS. . . . For example, ComEd can – and did in 2013 – incur return on equity penalties for not meeting specified reliability metrics." But the ROE penalties were set by the General Assembly in the EIMA law; they are not self-penalties that ComEd sets as part of the KPIs in its AIP. It is true that one of ComEd's KPIs is based on the EIMA statutory metrics

(*see, e.g.*, ComEd Ex. 19.0 at 11:198-12:216), but ComEd has no independent provision to reduce its own income when that KPI is not met. Second, to the extent that ComEd employees meet EIMA statutory reliability metrics, then there will be *no* ROE penalty; there is thus a *non-negative* correlation between achievement of that particular KPI and Exelon earnings. Third, despite ComEd having incurred a ROE penalty in 2013 of -0.05% related to service reliability targets (AG Cross Exhibit 12; ComEd Ex. 3.01, page 14, line 9, column D), the resulting downward adjustment of the cap on ComEd's ROE (ComEd Ex. 3.01, page 14 (Sch. FR D-1), line 11, columns B and D) resulted in *no actual ROE adjustment* to revenue requirement pursuant to Section 16-108.5(c)(5) of EIMA. ComEd Ex. 3.01, page 2 (Sch. FR A-1), lines 25 through 35.

**Applicable Law Supports the People's Position**

ComEd argues at page 43 of its Initial Brief that the People's interpretation of Section 16-108.5(c)(4)(A) would render "meaningless" the sentence stating that the Commission "shall" permit recovery of incentive compensation expense based on operational goals. However, as a preliminary matter, it should be noted that the full text of that subsection is as follows:

> The performance-based formula rate approved by the Commission shall do the following:
> . . . (4) Permit and set forth protocols, subject to a determination of prudence and reasonableness consistent with Commission practice and law, for the following:
> (A) Recovery of incentive compensation expense that is based on the achievement of operational metrics, including metrics related to budget controls, outage duration and frequency, safety, customer service, efficiency, and productivity, and environmental compliance. Incentive compensation expense that is based on net income or an affiliate's earnings per share shall not be recoverable under the performance-based formula rate;

The U.S. Supreme Court opinion language cited by ComEd at the bottom of page 42 of its Initial Brief stating that "[s]tatutory construction . . . is a holistic endeavor" is a useful canon here. As shown above, the text of EIMA requires that the formula rate "shall" permit and set forth protocols for recovery of incentive compensation expense based on operational goals, *subject to a determination of prudence and reasonableness consistent with Commission practice and law* (emphasis added). As the People showed in their Initial Brief at 34-37, Commission practice has consistently disallowed recovery of incentive compensation expense based on net income or an affiliate's earnings per share, *even when it is also based on operational goals*. ComEd's interpretation, not the People's, would render "absurd", to use ComEd's term from page 43 of its Initial Brief, the EIMA law by reading out of it the provision that incentive compensation expense based on an affiliate's EPS shall not be recoverable. As the People showed in their Initial Brief and above in this Reply Brief, all of ComEd's 2013 AIP expense was based on its affiliate's earnings per share; thus, just as the statute proscribes, it cannot be recoverable.

**The Commission Has Not Approved the Shareholder Protection Feature in the EIMA Era**

ComEd presents a specious history of recent Commission practice in support of its argument that the Commission should not disallow recovery of 100% of 2013 AIP expense. At page 45 of its Initial Brief, ComEd states that "[i]n Docket No. 11-0721, the Commission specifically based the amount of AIP recoverable under ComEd's 2010 plan on the amount determined pursuant to the net income limiter applicable to that plan." While it is true that the Commission's decision to allow recovery of 2010 AIP expense based on a 102.9% effective KPI index was in some sense a figure determined pursuant to the net income limiter applicable to that plan, the net income limiter was not a contested issue in that case, and the 102.9% was determined pursuant to the net income limiter *before* ComEd leadership decided to effectively

*cancel* the net income limiter that year. As the People showed at pages 37-38 of their Initial Brief, ComEd leadership decided in 2010 to effectively disable the net income limiter in the AIP after the net income performance percentage (102.9%) and the KPI index (110.3%, exceeding the net income performance percentage) were calculated. In that year, ComEd leadership decided under the CEO Discretionary Feature to increase the effective net income performance percentage to 112.9% – notwithstanding the *actual* performance of ComEd net income – a figure that, conveniently, exceeded the KPI index.[6] Thus, effectively, *there was no net income limiter in 2010.* The amount of AIP pay actually paid out in 2010, after consideration of the CEO Discretionary Feature, had *no* connection to ComEd's net income that year.

As the People showed in their Initial Brief at 38, in Docket No. 11-0721, the Commission allowed recovery of ComEd's 2010 AIP expense only to the extent that it reflected a 102.9% effective KPI index, rather than the 112.1% effective KPI index actually used in calculating ComEd's *actual* 2010 AIP expense. However, the reason for the Commission's decision was not an endorsement of the net income limiter that year as lawful. (Whether the Commission would have found the net income limiter to be lawful under Section 16-108.5(c)(4)(A) of EIMA had any party challenged it on that ground is unknown.) Rather, the Commission expressed a concern about the "potential for manipulation between" the AIP program and a second incentive pay program and sought to limit recoverable AIP expense to what the AIP expense would have been before the "manipulation." Order, Docket No. 11-0721, May 29, 2012, at 90. Moreover,

[6] According to the evidence from Docket No. 11-0721 cited by the People in their Initial Brief at 38, the CEO Discretionary Feature apparently increased the KPI index for 2010 from 110.3% to 112.1%, which was still below the increased net income limiter percentage of 112.9% also set through the CEO Discretionary Feature.

there is no evidence that the CEO Discretionary Feature[7] was used to alter the ComEd AIP payout in 2013, and the Shareholder Protection Feature applied to potentially limit all 2013 AIP pay rather than just above-target[8] AIP pay, making it even more difficult to draw any precedential lessons from the Commission's decision on the AIP issue in Docket No. 11-0721.

While Docket No. 11-0721 is not instructive, ComEd looks to its subsequent two formula rate proceedings for succor, stating at page 45 of its Initial Brief that "the AIP plans at issue in Docket Nos. 12-0321 (2011 plan), and 13-0318 (2012 plan) contained net income and Exelon EPS limiters, respectively, and no disallowance was made on the basis of those limiters." But, as the People showed at page 39 of their Initial Brief, the limiters were not contested issues in those two proceedings; ComEd even admitted as much in a discovery response in relation to Docket No. 12-0321 (AG Cross Exhibit 13 at 5). While ComEd self-disallowed some of its 2012 AIP expense in Docket No. 13-0318 and the Commission approved the recovery of 2012 AIP expense as if the Company Performance Multiplier had been 102.9%, the Commission did not comment on the issue in its Order and did not attempt to decide the lawfulness of the Exelon EPS limiter in the 2012 AIP plan. Staff Ex. 8.0 at 27:669-28:676. Moreover, ComEd has not shown that the limiters in those two cases had precisely the same factual contours as the Shareholder Protection Feature in the 2013 ComEd AIP plan. The lack of any comment by the Commission in the Orders of Docket Nos. 12-0321 and 13-0318 reflects only that the net income or Exelon EPS limiters of the AIP in 2011 and 2012 were not contested issues – not that the Commission considered the limiters and found them lawful.

[7] While the CEO Discretionary Feature existed on paper in ComEd's 2013 AIP (AG Ex. 1.7 at 10), Exelon Corp. leadership did not actually exercise it. The record does show that the Shareholder Protection Feature, which is based on Exelon EPS, *did* reduce the amount of 2013 ComEd AIP expense.

[8] As the People showed in their Initial Brief at 37, the net income limiter in the 2010 ComEd AIP applied to limit AIP pay "only if the composite payout exceed[ed] target level," as ComEd admitted in a discovery response entered into the record in Docket No. 11-0721.

ComEd writes at page 46 of its Initial Brief that in both of Docket Nos. 11-0721 and 12-0321, "the Commission's interpretation was that an incentive compensation program is not 'based on' EPS if the incentive compensation is earned pursuant to operational and cost control metrics, even though that earned award can be reduced by a limiter that is based on EPS. This is precisely the situation before the Commission again here." There are a number of infirmities with this passage. First, the ComEd AIP program in 2010 nominally had a limiter based on ComEd net income, not Exelon EPS. Second, the record in Docket No. 11-0721 showed that the net income limiter in 2010 was effectively disabled by the CEO Discretionary Feature. Third, the Commission made no such "interpretation" as to the lawfulness of the AIP in either of Docket Nos. 11-0721 or 12-0321, as discussed above.

Still on page 46 of its Initial Brief, ComEd then mentions the General Assembly's May 2013 passage of P.A. 98-0015[9], which amended certain portions of EIMA. ComEd represents that Section 1 of P.A. 98-0015 stated that "its express legislative purpose is to correct errant Commission decision-making under EIMA." That interpretation of the language in Section 1 seems generally correct: Section 1 states that the amendments "are intended to be a restatement and clarification of existing law" and that it is intended to give binding effect to House Resolution 1157[10] and Senate Resolution 821[11] from the 97th General Assembly, which generally objected to certain decisions of the Commission in Docket Nos. 11-0721 (ComEd) and

[9] The full text of P.A. 98-0015 is available online at http://www.ilga.gov/legislation/publicacts/98/PDF/098-0015.pdf.

[10] House Resolution 1157 in the 97th General Assembly, adopted as amended August 17, 2012, is available online at http://www.ilga.gov/legislation/97/HR/PDF/09700HR1157enr.pdf.

[11] Senate Resolution 821 in the 97th General Assembly, adopted as amended November 29, 2012, is available online at http://www.ilga.gov/legislation/97/SR/PDF/09700SR0821enr.pdf.

12-0001 (Ameren Illinois Company). Neither House Resolution 1157, Senate Resolution 821, nor P.A. 98-0015 mentioned the issue of incentive compensation.

ComEd then cites a sequence of Illinois Supreme Court and appellate cases holding that "where the legislature chooses not to amend a statute after a judicial construction, it will be presumed that it has acquiesced in the court's statement of the legislative intent." ComEd Initial Brief at 46-47. But importantly, *the Commission never made any construction or interpretation of the meaning of 'based on' in Section 16-108.5(c)(4)(A) of EIMA prior to*[12] *P.A. 98-0015*, as discussed above. Tellingly, ComEd has not directly quoted any language from any Commission order where the Commission construed the meaning of "based on" in Section 16-108.5(c)(4)(A) – which it could not do, because the Commission never made any such construction. While ComEd witness Mr. Prescott stated during re-direct examination that "[n]o AIP was disallowed [in 2012]" (Tr. at 291:20-22), he admitted on subsequent re-cross examination that he did not know whether the Commission made any explicit ruling in any prior proceeding that the Shareholder Protection Feature in ComEd's 2012 AIP was compliant with applicable law (Tr. at 295:20-296:13). As Staff witness Bridal stated in his rebuttal testimony, in Docket No. 12-0321, "the AIP costs included in the revenue requirement were approved without Commission comment" (Staff Ex. 8.0 at 27:664-666) and in Docket No. 13-0318, "the AIP itself was again not specifically addressed by the Commission" (*id.* at 28:675-676). As Staff stated in its Initial Brief at 41-42, "the approval of a revenue requirement in absence of the discussion of all of its components does not provide implicit approval of every cost included in the development of the approved revenue requirement."

[12] EIMA was passed in October 2011; Docket No. 11-0721 was decided in May 2012; Docket No. 12-0001 (Ameren Illinois Company) was decided in September 2012; Docket No. 11-0721 on rehearing was decided in October 2012; and Docket Nos. 12-0293 (Ameren) and 12-0321 (ComEd) were decided in December 2012.

**Commission Practice Has Consistently Disallowed Recovery of Incentive Compensation Expense Dependent on a Parent Company's Financial Performance**

ComEd states that "the Commission has never disallowed ComEd's AIP expense when it was subject to a limiter based on EPS or net income," a misleading contention that fails to mention that ComEd's EPS or net income limiters in its AIP programs have not been contested issues in Commission rate cases. ComEd betrays a poor grasp of recent history by failing to mention that the Commission disallowed 100% of Ameren Illinois Company's test-year incentive compensation expense in Docket Nos. 06-0070 *et al.* (cons.), where, as the Commission found, "all operational goals are dependent upon meeting the EPS target first", as the People described at page 34 of their Initial Brief. Similarly, in Docket Nos. 07-0585 *et al.* (cons.), the Commission disallowed the portion of Ameren's 2006 test-year incentive compensation expense that, in addition to being based on operational goals, was dependent upon the parent company's meeting EPS targets, as the People showed at page 35 of their Initial Brief. ComEd also suggests at page 48 of its Initial Brief that, in Docket No. 05-0597, the operational-based portion of AIP pay of which the Commission allowed recovery was "subject to the Exelon EPS limiter" (ComEd Initial Brief at 48). However, as the People showed in their Initial Brief at 35-36, (1) the Shareholder Protection Feature applying to the AIP for that proceeding's test year applied only to above-target performance, and ComEd was seeking recovery of AIP expense only up to the target level – a key distinction from the 2013 ComEd AIP, where the Shareholder Protection Feature applies potentially to *all* AIP pay, and (2) the Shareholder Protection Feature was not mentioned either in any party's briefing or in the Commission's Order in that proceeding.

ComEd correctly states at page 49 of its Initial Brief that in Docket No. 07-0566, the Commission completely disallowed recovery of the portion of AIP expense that was based on the

net income metric. However, ComEd then represents that the Commission "allowed recovery of the remainder of the award that was subject to the Exelon EPS limiter." *Id.* As the People showed at page 37 of their Initial Brief, there was no mention of any EPS limiter in briefing in Docket No. 07-0566, and the Commission's order similarly did not mention it, so the Commission's decision can hardly be taken as an endorsement of the lawfulness of an Exelon EPS limiter.

At page 49 of its Initial Brief, ComEd also seizes upon an unrelated issue in Docket No. 07-0566 – how to allocate employee payroll between ordinary utility functions versus non-recoverable merger work – in support of its position on AIP recovery in *this* docket. In that case, the Commission considered whether to allow recovery of the salaries of employees who had worked on the cancelled merger of Exelon Corp. with Public Service Enterprise Group.[13] The Commission ultimately disallowed[14] recovery of 25% of the disputed employee salaries, "though it never explained how it arrived at that figure," as ComEd describes it in its Initial Brief at 49. ComEd then cites an Appellate Court, Second District opinion that upheld the Commission's decision in that docket, holding that "once [the Commission] identifies a recoverable cost item . . . the Commission is not authorized to treat the expense as zero." But here, *none* of the 2013 AIP expense is a recoverable cost item. The AIP pay actually paid out cannot be apportioned or allocated between recoverable amounts not based on Exelon EPS versus non-recoverable amounts based on Exelon EPS. For the reasons described above, *all* 2013 AIP expenses were unlawfully[15] based on Exelon EPS.

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[13] Order, Docket No. 07-0566, September 10, 2008, at 62.

[14] Order, Docket No. 07-0566, September 10, 2008, at 64.

[15] The Seventh Circuit case of *U.S. v. Ray* and the Illinois Appellate Court case of *Manuel v. Red Hill Community Unit School Dist. No. 10 Bd. of Educ.*, discussed at pages 31-33 of the People's Initial Brief, also provide judicial interpretations of the term "based on" that support the People's position. However, after filing their

**Staff's Alternative Lacks a Sound Basis**

In assessing the ICC Staff's alternative proposal for 2013 AIP expense recovery, the Commission should note that Staff's *principal* recommendation is that the Commission adopt the AG adjustment to disallow 100% of ComEd's 2013 AIP expense. Staff Initial Brief at 24. ComEd suggests that the Staff *alternative* proposal of allowing recovery of AIP expense as if the effective Company Performance Multiplier had been 102.9% is "reasonable" and "consistent with longstanding Commission precedent" (ComEd Initial Brief at 47), but ComEd fails to provide any basis for these assertions. As ComEd witness Ms. Brinkman stated in her surrebuttal testimony, "the 102.9% figure [allowed for recovery in Docket No. 11-0721] was based on facts specific to the 2010 AIP plan" but "102.9% does not specifically relate to the 2013 AIP plan." ComEd Ex. 25.0 at 3:62, 60. As the People stated at page 40 of their Initial Brief, there is no prudential or legal basis to import the Commission's AIP expense recovery cap from Docket No. 11-0721 into this docket.

Even *Staff* did not provide any calculations in its Initial Brief related to the facts of the 2013 ComEd AIP plan to support the specific 102.9% figure in its alternative proposal, other than to say that: (1) the same percentage was allowed in Docket No. 11-0721; (2) this figure "would result in recovery of 100% of the fair market value of employees' salaries plus a small, reasonable bonus"; and (3) the alternative proposal would "effectively negate[] any impact" of the Shareholder Protection Feature. Staff Initial Brief at 45. But for reasons discussed above,

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Second Corrected Initial Brief, the People learned that the Seventh Circuit case of *U.S. v. Bank of Farmington*, 166 F.3d 853 (1999) cited at page 33 of their Initial Brief, was overruled as to the interpretation of "based upon" by a later Seventh Circuit opinion, *Glaser v. Wound Care Consultants, Inc.*, 570 F.3d 907 (2009), which held that "based upon" means "substantially similar to", which makes little sense in the context of trying to interpret Section 16-108.5(c)(4)(A) of EIMA (one cannot conceive of "incentive compensation expense that is substantially similar to net income or an affiliate's earnings per share"). The People sincerely regret the oversight and cannot rely on either *Farmington* or *Glaser* in support of their position, although the other Seventh Circuit case of *Ray* and the Illinois Appellate Court case of *Manuel* are still good law.

the Commission's justification in Docket No. 11-0721 for approving recovery based on a 102.9% KPI index was unique to that docket; there is no evidence that 100% of the target incentive opportunity percentage is a "market" rate of incentive compensation[16]; and the 102.9% proposal does not "negate any impact" of the Shareholder Protection Feature. Negating the impact of the Shareholder Protection Feature would require that ComEd give its employees $8.5 million in additional AIP pay relating to 2013. ComEd Ex. 12.0 (Rev.) at 6:117-118.

Similarly, ComEd suggests twice in its Initial Brief, at page 39 and again at page 50, that if the Commission finds the Shareholder Protection Feature to be unlawful[17], the Commission should "eliminate that limiter, not disallow ComEd's AIP expense in its entirety." But it is not clear how the Commission could "eliminate" the Shareholder Protection Feature from ComEd's 2013 AIP expense. The Commission cannot commandeer a souped-up DeLorean and travel back to 2013 to persuade the Compensation Committee of Exelon to remove the Shareholder Protection Feature from ComEd's AIP.[18] 2013 AIP expense has already been calculated and paid, based in part on the unlawful Shareholder Protection Feature. It does not appear that ComEd is proposing to retroactively "eliminate" the Shareholder Protection Feature by paying its employees an additional $8.5 million[19] to give them, in total, what they would have received in

[16] ComEd's outside compensation expert, Mr. Wathen, stated during cross-examination in response to a question asking whether he had an opinion as to the market-competitiveness of ComEd's pay levels: "I cannot specifically speak to that. I did not do any analysis to that end." Tr. at 106:12-16. ComEd's Vice President of Corporate Compensation, Mr. Prescott, stated that the AIP and the Long-Term Performance Program ("LTPP") are "part of a total compensation package at market levels" (ComEd Ex. 18.0 (Rev.) at 14:278-280; *see also* ComEd Ex. 31.0 at 3:60-61), but he did not speak specifically to whether the AIP alone is set at a market level. The total compensation package under Mr. Prescott's formulation would include base salary, AIP pay, and LTPP pay. Mr. Prescott also stated that "if employees want to earn market-level compensation, they need to ensure that ComEd meets its operational metrics" (*id.* at 4:79-80), but he did not specify that meeting operational goals under the AIP is *sufficient* to earn market-level compensation, only that it is *necessary*.

[17] The phrasing ComEd uses is "[i]f the Commission dislikes the limiter".

[18] Even if the Commission could, in fact, go back in time, it still would not have the legal authority to order ComEd to cancel the Shareholder Protection Feature; it can only allow or disallow recovery of particular costs.

[19] *See* ComEd Ex. 12.0 (Rev.) at 6:117-118.

2013 AIP pay if the Shareholder Protection Feature, hypothetically, had not been in place. And the Commission certainly cannot allow ComEd to recover a counter-factual amount of AIP cost based on a hypothetical 140.39% effective Company Performance Multiplier, if a lesser amount of AIP cost was actually incurred.

**Summary**

ComEd states on page 39 of its Initial Brief that the People's proposal to disallow recovery of all 2013 AIP costs is "disproportionate" "if the Commission were to agree with the AG that a portion of the program is now somehow contrary to the statute."[20] But the premise in this formulation is wrong; the People do not argue that "a portion of the [AIP] program" is unlawful. Rather, because the Shareholder Protection Feature applies to every dollar of AIP expense and can, depending on the value of Exelon EPS, reduce to zero every dollar of AIP expense that is "earned" (to use the term used by ComEd in its Initial Brief at 41) through achievement of operational KPIs, every dollar of AIP expense actually paid out is based on Exelon Corp.'s earnings per share. Thus, alternative proposals such as Staff's that would allow recovery of anything above 0% of 2013 AIP expense are contrary to law, and the Commission should dismiss them. In summary, for the reasons stated in this Reply Brief and in the People's Initial Brief at 10-41, the Commission should disallow 100% of ComEd's 2013 AIP costs, including the portion of AIP pay to Exelon Business Services Company employees that has been included in ComEd's asserted revenue requirement. As the People described in their Initial Brief

[20] Similarly, ComEd states at page 48 of its Initial Brief that the Commission should not disallow all 2013 AIP expense "when at the very least a portion of that incentive compensation is clearly recoverable."

at page 10, the revenue requirement impact of their proposal is $39,145,065[21] in each of the 2013 reconciliation year revenue requirement and the 2015 initial rate year revenue requirement.

b. Key Manager Long Term Performance Plan ("LTPP")

c. Long-Term Performance Share Awards Program ("LTPSAP")

ComEd opposes the proposal of AG witness Brosch to disallow all of the Long-Term Performance Share Award Program ("LTPSAP") expense that ComEd seeks to include in revenue requirement, with a revenue requirement impact of $187,437. (According to ComEd's rebuttal testimony, ComEd Ex. 12.0 (Rev.) at 11:217-224, and ComEd's Initial Brief at 52, ComEd is now seeking to include 5.7% of its 2013 LTPSAP expense in revenue requirement.) ComEd asserts at page 53 of its Initial Brief that, notwithstanding the Compensation Committee's reduction of 2013 payout from 147.8% to 125%, "[s]ince ComEd's performance met the distinguished level in 2013, a higher performance of payout is supportable for ComEd," citing rebuttal testimony of Ms. Brinkman. As the People showed in their Initial Brief at 41, the Commission found in Docket No. 13-0318 that the 2012 LTPSAP "depend[ed] on a management committee's subjective assessment of the performance of all Exelon subsidiaries."[22] Because the Compensation Committee of the Exelon Board of Directors reviewed the results of the LTPSAP in 2013 and limited the total payout from 147.8% to 125% (AG Ex. 1.0C2 at 27:615-619), it is not clear that the Commission's concern about subjective assessments should be allayed as regards the 2013 plan.

[21] ComEd's description of the People's proposed adjustment as worth "roughly $66 million" (ComEd Initial Brief at 38) is incorrect. *See* AG Ex. 3.1 at 2, line 29; ComEd Ex. 12.01 (Rev.), line 29.

[22] The management committee's "subjective assessment of the performance of all Exelon subsidiaries" in relation to LTPSAP expense can be contrasted with the CEO Discretionary Feature in the AIP, which does not by its terms obviously relate to other Exelon subsidiaries. AG Ex. 1.7 at 10.

ComEd also admits in its Initial Brief at 53 that "it is true that LTPSAP payouts are subject to an overall Total Shareholder Return ("TSR") modifier." ComEd argues, however, that Staff witness Bridal's characterization of TSR as "financial measures of the type that the Commission has disallowed in previous proceedings" (Staff Ex. 8.0 at 35:831-832) is inaccurate because, while "the Commission has disallowed ComEd's incentive compensation when the amount earned was based on Exelon's EPS or ComEd's net income . . . [t]he Commission has never disallowed incentive compensation in past ComEd proceedings because the amount was subject to a total shareholder return modifier." ComEd Initial Brief at 53-54. ComEd's argument appears to mischaracterize or ignore the word "type" used by Mr. Bridal. While it may be literally true that the Commission has never considered or disallowed recovery of ComEd's incentive compensation based on the TSR, ComEd made no effort in testimony or in its Initial Brief to show that the TSR is not of a like "type" as EPS or net income.

As the People showed in their Initial Brief at 42, the LTPSAP payouts remain subject to the TSR modifier that can increase or decrease overall LTPSAP plan awards by up to 25%, which is a larger overall weighting than has been afforded the CAIDI and SAIFI factors relied upon for ComEd's proposed 13.5% (later modified by ComEd to 5.7%) percent recovery rate. AG Ex. 1.0C2 at 26:606-609; AG Ex. 1.8 at 3-6; ComEd Ex. 2.01 at 12-13. ComEd's discovery response reproduced at AG Exhibit 1.8 at 3-6 shows that the TSR modifier is based on a three-year average of Exelon Corp. shareholder return, compared to an identically calculated index for peer companies. Page 6 of that exhibit defines the 1-year "Total Shareholder Return" as "a standard measure of the performance of a company's stock over time. It combines share price appreciation and dividends paid to show the total return to the shareholder expressed as an annualized percentage." In light of Commission decisions discussed above disallowing incentive

compensation expense based on financial metrics of the parent company, the Commission should disallow ComEd's proposed recovery of 2013 LTPSAP expense that is based on the TSR modifier.

In light of the Total Shareholder Return modifier and the Compensation Committee's subjective decision to reduce LTPSAP payout in 2013, the Commission should disallow recovery of 100% of ComEd's LTPSAP expense, rather than the 94.3% disallowance recommended by ComEd, for the reasons stated here and in the People's Initial Brief at 41-43.

3. Collection Agency Costs

## VI. RATE OF RETURN

## VII. RECONCILIATION

### A. OVERVIEW

### B. POTENTIALLY CONTESTED ISSUES

1. Calculation of Interest on Reconciliation Balance Net-of-Tax

**Overview**

The Commission has before it a recurring question about how to apply the interest provision of Section 16-108.5 to the reconciliation under- or over-recovery. That question hinges on (1) the overall purpose of the reconciliation interest provisions and (2) the fact that regulatory accounting recognizes the effect of book-tax differences on the financing needs and capital available to utilities. As the Appellate Court stated in *Ameren Ill. Co. v. Ill. Comm'rce Comm'n*, 2013 IL App (4th) 121008, ¶ 34:

> ADIT quantifies the income taxes that are deferred when the tax law provides for deductions with respect to an item in a year other

> than the year that the item is treated as an expense for financial reporting purposes." (Internal quotation marks omitted.) Ameren Illinois Co. v. Illinois Commerce Comm'n, 2012 IL App (4th) 100962, ¶ 11, 967 N.E.2d 298. For regulated utilities, ADIT reduces the utility's rate base because it is treated as no-cost capital. Ameren Illinois Co., 2012 IL App (4th) 100962, ¶ 11, 967 N.E.2d 298. In other words, ADIT represents taxes payable in the future that provide a source of funds the utility can use until such time the taxes become due.

The *Ameren* Court affirmed the Commission's deduction of ADIT from Ameren's rate base in its annual formula rate review despite the lack of any specific reference to it in Section 16-108.5. *Id*. at ¶ 40.

The purpose of the reconciliation interest must be considered in light of the overall goal of the formula rate law to compensate the utility for its *actual* costs. See 220 ILCS 5/16-108.5(c) and ComEd Initial Brief at 7-10. It is basic statutory construction that all aspects of a statute are to be read together to harmonize them consistent with the law's overall purpose. As the Illinois Supreme Court has stated:

> it is not sufficient to read a portion of the statute in isolation. We must, instead, read the statute in its entirety, keeping in mind the subject it addresses and the legislature's apparent objective in enacting it. *Gill v. Miller*, 94 Ill.2d 52, 56, 67 Ill.Dec. 850, 445 N.E.2d 330 (1983). Where the language of the statute is clear and unambiguous, we must apply it as written, without resort to other tools of statutory construction. *Raintree Homes, Inc. v. Village of Long Grove*, 209 Ill.2d 248, 255, 282 Ill.Dec. 815, 807 N.E.2d 439 (2004). Generally, the language of a statute is considered ambiguous when it is capable of being understood by reasonably well-informed persons in two or more different senses. *In re B.C.*, 176 Ill.2d 536, 543, 223 Ill.Dec. 919, 680 N.E.2d 1355 (1997).

*Mid Electrical Contractors, Inc. v. Abrams*, 228 Ill.2d 281, 287-288 (2008). The overall purpose of Section 16-108.5 is to reconcile the utility's revenue requirement every year so that the utility recovers revenues sufficient to cover its actual costs during the annual formula rate cycle.

Because the reconciliation takes time to both calculate and recover, there is a time gap between when costs are incurred and paid and when the reconciliation revenues – to make up any gaps in revenue recovery – are received. The interest provision of Section 16-108.5(d) provides the utility with interest to compensate it for the value of that delay.

Section 16-108.5 was enacted in October 2011 and amended in May 2013 by Public Act 98-0015. The amendment changed the determination of the interest rate *from* one that had been determined by the Commission to reflect actual expected cost *to* a rate equal to the utility's weighted average cost of capital. The amendments did not include any other directives, leaving the Commission with the task of applying the newly designated interest rate so that the utility recovers its actual costs and consumers pay the utility's actual costs: no more and no less.

In this docket, ComEd has argued that consumers should pay rates that include interest on funds (taxes) before ComEd pays those funds out (to the government). ComEd Initial Brief at 56-57. ComEd's own witness, Mr. James Warren, testified that the cost to ComEd of the delay in recovering the reconciliation balance must be adjusted to remove the taxes that consumers will pay as part of the reconciliation amount if consumers are to pay the *actual* cost to ComEd associated with the delay. ComEd Ex. 23.0 at 8:164-167. The facts and the appropriate accounting treatment to reflect actual cost are not in dispute. However, ComEd argues that the Commission should ignore the goal of the reconciliation to cover ComEd's actual costs and:

(a) continue the misapplication of regulatory accounting that resulted from its last ComEd formula rate order (docket 13-0318);

(b) ignore the actual effect of the delay in tax payments associated with the delayed recovery of the reconciliation balance because allegedly the tax timing difference "provides no source of funds to the utility," and

(c) apply a "model" developed by its hired expert specifically as a theory to justify charging consumers more than ComEd's actual costs associated with financing the cash flow related to the reconciliation balance and under-collection.

See ComEd Initial Brief at 57, 58, 59. The People will show that ComEd's arguments are self-serving and without merit.

**a. ComEd's Argument That The People's Proposal Is Inconsistent with ComEd's Formula and Past Decisions Ignores the Substance of The People's Proposal.**

ComEd argues that AG witness Effron's recommendation that the Commission only apply interest to the net-of-tax reconciliation balance should be rejected because the Commission has rejected it before. ComEd Initial Brief at 57-58. However, ComEd does not address the fact that the Commission invited further argument on this issue in its Order in Docket No. 13-0553.[23] Therefore, the fact of prior rejection does not, alone, preclude further consideration of Mr. Effron's recommendation.

**b. ComEd Mistakenly Relies On Whether There Is A "Cash Benefit" In Arguing Against Applying The Interest To The Net-Of-Tax Reconciliation.**

ComEd concedes, as it must, that "deferred tax liability is properly deducted from a utility's rate base because … [it is] a source of capital for ComEd not provided by investors but by the U.S. Treasury." ComEd Initial Brief at 58. ComEd then takes a wrong turn by arguing that the deduction is based on "cash benefit from that taxpayer 'investment.' " *Id.*

ComEd seeks to conflate the deferred tax payable in the future when the reconciliation revenues are actually recovered with the utility's receipt of "cash." This argument ignores the issue: assuming the receipt of cash is deferred, *and the payment of taxes is also deferred*, what is the

[23] "In the future, if further arguments from the parties are presented or clarity from the legislature is provided on this topic, the Commission will revisit the issue." Order, Docket No. 13-0553, November 26, 2013, at 43.

amount of cash the utility must finance while it awaits receipt of the reconciliation revenues? If the goal of the statute is to provide the utility with revenues to cover its *actual* costs, the utility should not include interest on taxes that have not been paid in the reconciliation balance. See AG Ex. 2.0 at 8:167-171 ("In effect, the $93,300,000 [tax expense that comprises part of the reconciliation balance] represents an amount that was not paid in income taxes because the revenue requirement in effect in 2013 was lower than the actual revenue requirement for that year. When that revenue requirement variance is recovered from customers, the income will go to shareholders and the income taxes will go to the state and federal governments"). The question of whether the deferred tax associated with the reconciliation balance produces "cash" is irrelevant to the proper application of interest to the net-of-tax reconciliation balance of the prior year's revenue requirement. *See also* AG Ex. 2.0 at 9:186-189 ("ComEd does not owe the income taxes [on a reconciliation under-collection] until the revenues are actually received, and so does not owe the government any interest on the deferred tax amounts. Allowing ComEd to recover interest on these amounts would allow the Company to recover interest that it does not actually have to pay"). ComEd's foregone cash flow is the net-of-tax revenue it would have received if its revenue requirement authorized in the reconciliation year had been correct.

ComEd also compares its reconciliation under-collection balance to a situation "in which a utility is not paid by a customer for two years while that customer reorganizes," citing Ms. Brinkman's rebuttal testimony. ComEd Initial Brief at 58-59. ComEd argues that this "situation also results in a deferral of the tax liability related to the payment because the utility does not pay a tax until it is paid, but no ADIT adjustment is made for uncollected revenue." *Id.* But ComEd provides no information to suggest that the hypothetical account receivable receives some sort of return or interest, as the reconciliation under-collection balance does pursuant to Section 16-

108.5(d)(1) of EIMA. If the account receivable *did* receive a return or interest, then the hypothetical troubled customer would have a good argument that the return or interest should be on the net-of-tax amount owed, for reasons stated above in relation to the reconciliation balance.

**c. ComEd's "Models" Were Invented To Support ComEd's Position And "Consistent" Application Of The Models Ignores The Terms Of Section 16-108.5.**

ComEd's Initial Brief muddies the issue presented by Mr. Effron (the application of interest to the net-of-tax reconciliation balance to reflect the Company's actual costs due to under-collection) by using the terms "deferred taxes" without acknowledging the actual, underlying reality of what the reconciliation interest is supposed to do and how the reconciliation interest can and should be applied to the reconciliation balance under-collection. *See* ComEd Initial Brief at 59. ComEd also mixes the application of interest on the reconciliation under-collection with the later taxes that would become due as a result of collecting the interest on that reconciliation under-collection, as opposed to taxes that result from receipt of the reconciliation revenues. *Id*. ("It is inconsistent to argue, as the AG and CCI do, that ComEd receives a deferred tax benefit well before the reconciliation revenues are ever collected, while denying that the interest payment results in taxes that should be recoverable"). The interest on the reconciliation under-collection should, in theory and consistent with the goal of the statute to equate revenue requirement reconciliation with actual costs, be equal to ComEd's interest expense incurred to finance the under-recovery during the recovery period. Because the Commission has previously determined that the reconciliation under-collection balance is financed by debt, and interest on debt is tax deductible, the interest income should be offset by the interest deduction. AG Ex. 4.0 at 10:227-234; Tr. at 55:1-4 (Warren). Accordingly, ComEd's argument that taxes on the

interest income somehow justifies charging consumers interest on taxes before ComEd has paid those taxes is misplaced and not consistent with well-known tax accounting.

ComEd also relies on the "models" presented by its hired expert Mr. James Warren. Mr. Warren could produce no citation to studies, reports, or any other documentation supporting his notion that there is a "cost-based model" and a prescribed interest model." Tr. at 25-27. Rather, he admitted that he developed his models for this case. Tr. at 28:17-20. Once he created the models, he asserted that the Commission must apply one model or the other. ComEd Initial Brief at 59. The problem with Mr. Warren's model is that it does not comport with the statute. The statute's provisions and goals set the framework for formula rates, whatever Mr. Warren may think of their consistency.

As discussed above in the Overview and in the People's Initial Brief, the statute is clear that its goal is to match the utility's actual costs to its revenue requirement, to the extent of annual retrospective review of actual costs and revenue requirement (subject to the ROE "collar") and recovery of the utility's under- or over-collection in the following year's rates. 220 ILCS 5/16-108.5(d). While the statute originally left the determination of the appropriate interest rate to apply to the reconciliation under- or over-collection to the Commission, presumably to determine an "actual" cost, in 2013 the General Assembly enacted changes to the statute that selectively specified one aspect of the reconciliation equation: the interest rate. This isolated amendment to the reconciliation over- or under-collection mechanism cannot be ignored under the guise of consistently applying a model that ComEd's witness created for purposes of this case. Rather, the General Assembly established the framework wherein the interest – not a return on rate base – is applied to the reconciliation balance, and the reconciliation balance itself

to which interest is applied is (1) subject to adjustment to reflect actual over- or under-collection and (2) not included in rate base.

AG witness Mr. Effron's recommendation to reduce the reconciliation balance for purposes of the interest calculation thereon to reflect that the *actual* foregone *income* is net-of-tax is consistent with the provisions of the statute. It applies the specified interest rate (equal to the utility's weighted average cost of capital, but not an equity return) to the actual under-collection, represented by the foregone cash flow that the utility presumably will need to finance pending recovery of the reconciliation balance. As ComEd witness Mr. Warren recognizes, a cost-based approach requires that the interest rate be applied "to the reconciliation undercollection reduced by the associated ADIT balance." ComEd Ex. 23.0 at 8:166-167; Tr. at 32:11-15. Mr. Effron's recommendation is consistent with the goals and provisions of the statute; the internal consistency and symmetry that ComEd requests is not authorized or consistent with the statute it seeks to apply.

**d. ComEd's "Models" Were Invented To Support ComEd's Position And "Consistent" Application Of The Models Ignores The Terms Of Section 16-108.5.**

If the Commission is still concerned about EIMA's silence regarding Mr. Effron's proposed ADIT offset, the required alternative remedy is to include recorded reconciliation-related ADIT in rate base, as Mr. Brosch proposed in testimony and the People described at pages 48-53 of their Initial Brief. These amounts are based upon the Company's accounting estimates and are clearly ICC-jurisdictional, arising solely from the reconciliation ratemaking procedures under EIMA. ComEd has made no showing that these recorded ADIT balances are properly excluded from rate base or that they relate to any deregulated business function or other jurisdiction such as FERC.

In its Initial Brief at 61, ComEd addresses Mr. Brosch's alternative proposal by arguing, first, that "it too fails to recognize that this ADIT does not provide any rate year cash benefit or source of financing to ComEd." But, for reasons discussed above, the ADIT related to the reconciliation under-authorization represents the portion of the reconciliation balance that would *not* be net income to ComEd had it been collected in the reconciliation year; thus, Mr. Brosch's proposed treatment would offset the incorrectly high interest calculated on the reconciliation balance if Mr. Effron's proposed adjustment were not adopted. ComEd argues on the same page of its Initial Brief that Mr. Brosch's alternative proposal would create a mismatch because the reconciliation balance itself recovers interest at only the weighted average cost of capital, without a tax gross-up, while the rate base recovers a return at the weighted average cost of capital *with* a tax gross-up. However, this argument is entirely a vestige of Mr. Warren's "prescribed" versus "cost-based" view of the issue, which was addressed in the Peoples' Initial Brief and above. The WACC-based interest percentage required by statute does not leave room for perfect matching of income tax effects, but any imprecise matching of effective return rates does not justify completely ignoring the ADIT tax deferral benefits as advocated by ComEd. Mr. Brosch explained that, while the People's primary recommendation advanced by Mr. Effron may be more precise and is therefore the primary recommendation, the rate base inclusion alternative is much more reasonable than ComEd's proposal to keep all of the reconciliation tax deferral benefits for the sole benefit of shareholders. AG Exhibit 3.0 at 18:420-19:431.

**Summary**

As the People showed at page 53 of their Initial Brief, if either the ADIT offset approach proposed by Mr. Effron or the rate base inclusion approach proposed by Mr. Brosch are not approved, ComEd will experience a windfall deferred tax benefit that is retained for the sole

benefit of Exelon shareholders. For the reasons stated in this Reply Brief and in their Initial Brief at pages 44-53, the People therefore principally recommend that the Commission adopt Mr. Effron's proposed adjustment to the calculation of interest on the reconciliation balance, or *as an alternative,* that the Commission adopt Mr. Brosch's proposed adjustment to the Company's rate base.

## VIII. REVENUES

### A. OVERVIEW

### B. POTENTIALLY CONTESTED ISSUES

#### 1. Billing Determinants

ComEd accurately characterizes the dispute in this proceeding regarding billing determinants at page 63 of its Initial Brief: should 2013 weather-normalized billing determinants[24] be used in setting 2015's rates (as ComEd proposes), or should the billing determinants be adjusted upward for the projected increase in customers during 2014 (as the People recommend)? ComEd admits at footnote 16 on page 63 of its Initial Brief that "the Commission has directed in prior cases" that ComEd follow the treatment that the People recommend in this proceeding. As the People demonstrated in their Initial Brief at 54, the Commission approved the People's proposed treatment in each of Docket Nos. 11-0721 and 12-0321, and the Appellate Court twice approved the Commission's decisions. In its review of the Docket No. 12-0321 decision, the Appellate Court found ComEd collaterally estopped from further challenging the Commission's authority to make this decision. AG Initial Brief at 54.

[24] EIMA specifies that in establishing rates to be collected initially for a given year, the billing determinants should be "historical weather normalized billing determinants." 220 ILCS 5/16-108.5(c)(4)(H).

ComEd argues at page 63 of its Initial Brief that the People's proposal would "result in rates that would permanently deprive ComEd of the opportunity to recover the revenue requirement reflecting 2013 costs." Moreover, ComEd suggests at page 64 of its Initial Brief that the People's proposed adjustment creates a "one-sided" risk that causes the utility to "always and consistently under-recover."[25] But *nowhere in its Initial Brief did ComEd demonstrate why the People's proposal creates a one-sided risk.* In Docket No. 11-0721, the Commission characterized the AG's identical proposal as simply "ensur[ing] that the billing determinants are based on accurate information."[26]

ComEd has not shown why adjusting billing determinants upward for the projected increase in customers creates an "intentional overstatement of customers" rather than an accurate estimate. As AG witness Mr. Effron stated in rebuttal testimony, the 2015 initial rate year revenue requirement determined in this proceeding will reflect 2014 projected plant additions, and "the additional customers associated with the 2014 plant additions should be reflected in the billing determinants used to establish 2015 rates." AG Ex. 4.0 at 3:54-61. As Mr. Effron noted, it would be a "clear mismatch" if 2015 rates to produce 2015 actual revenues were based on 2013 billing determinants. *Id.* at 3:69-4:71. ComEd witness Ms. Brinkman agreed during cross-examination that, hypothetically, if 2013 billing determinants were used in setting 2015 rates but, in the meantime, the number of customers grew 10% from 2013 to 2015, and if the only charge were per-customer, then ComEd would collect 10% more than the authorized revenue requirement in 2015. Tr. at 204:4-206:7. Mr. Effron stated in his direct testimony that

[25] Relatedly, ComEd complains at pages 63-64 of its Initial Brief that "only revenue requirements are reconciled under EIMA, not revenues or billing determinants. No mechanism allows ComEd to recover *revenues* which it failed to receive in 2015 not because costs were understated, but instead because billing determinants were overstated."

[26] Order, Docket No. 11-0721, May 29, 2012, at 75.

"recognizing one year of *reasonably* expected customer growth partially mitigates" the mismatch of using 2013 billing determinants for setting 2015 rates. AG Ex. 2.0 at 6:118-119 (emphasis added).

While ComEd relies at page 65 of its Initial Brief on testimony by Ms. Brinkman noting that "the Commission has made no analogous adjustments to Ameren Illinois Company's (or its predecessors') historical weather normalized billing determinants," the billing determinants of Ameren Illinois Company are not at issue in this proceeding. Moreover, the Docket No. 11-0721 adjustment on this issue was made because ComEd had "proposed the building of new facilities to accommodate growth in the number of customers it serves," as the Appellate Court found. AG Initial Brief at 54. Ms. Brinkman admitted during cross-examination that she had made no contentions in testimony about Ameren's customer growth; that she had no knowledge about whether Ameren's projected plant improvements include new business; and that if Ameren's customer growth were zero, there would be no basis for a similar adjustment as what the People recommend here. Tr. at 213:14-215:12.

In summary, the Commission should continue to adopt the People's proposal to adjust historical weather-normalized billing determinants upward for projected customer growth, for the reasons stated herein and in the People's Initial Brief at 54-55.

## IX. COST OF SERVICE AND RATE DESIGN

### A. OVERVIEW

### B. POTENTIALLY UNCONTESTED ISSUES

1. Embedded Cost of Service Study

2. Distribution System Loss Factor Study

3. Secondary and Service Loss Study

## X. OTHER

### A. OVERVIEW

### B. POTENTIALLY UNCONTESTED ISSUES

### C. POTENTIALLY CONTESTED ISSUES

## XI. CONCLUSION

For all of the reasons stated above, the People of the State of Illinois respectfully request that the Commission enter an Order consistent with the recommendations in this Reply Brief and in their Initial Brief.

Respectfully submitted,

The People of the State of Illinois
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